

No. 13111

IN THE
**United States Court
of Appeals**
FOR THE NINTH CIRCUIT

IDALIA O. FRATT,

Appellant,

vs.

JOHN R. ROBINSON and

JANE DOE ROBINSON,

Husband and wife, et al.,

Respondents.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN. DIVISION

OPENING BRIEF OF APPELLANT

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Appellant,

vs.

JOHN R. ROBINSON and JANE DOE ROBINSON,
husband and wife; TED R. ROBINSON and
JANE DOE ROBINSON, husband and wife;
LAURA R. MCLEOD and JOHN DOE
MCLEOD, wife and husband; J. S. ROBIN-
SON, and JANE DOE ROBINSON, husband
and wife; and A. W. V. FORD and JANE
DOE FORD, husband and wife, individually
and as Officers and Directors of Robinson
Plywood and Timber Company, a corpora-
tion; W. E. DIFFORD and JANE DOE DIFFORD,
husband and wife; and SAMUEL P. MCGHEI
and JANE DOE MCGHEI, husband and wife,
individually and as agents for the afore-
mentioned defendants, and as agents for the
Robinson Plywood and Timber Company;
and the ROBINSON PLYWOOD & TIMBER
COMPANY, a corporation (formerly known
as the Robinson Manufacturing Company,

Respondents.

INTRODUCTION

As set forth in Appellant's Statement of Points,
this is an appeal from an order and judgment of dis-
missal of plaintiff-appellant's action upon the ground
that the security transactions set forth in the complaint

were not within the purview of the Securities Exchange Act of 1934 (R. 47). Three other grounds urged for dismissal but overruled by the trial court will be presented in this brief. These are:

(a) That the action was not commenced within the time limited by law.

(b) That the Securities Exchange Act of 1934 does not provide a civil right of action for the type of claim alleged in plaintiff's complaint.

(c) That the allegations of use of means and instrumentalities of interstate commerce and of the mails are insufficient.

JURISDICTIONAL STATEMENT

This action arose under the Securities Exchange Act of 1934, as amended, Public Law No. 291, 73 Congress N. R. 7263, 40 Stat. 681, U.S.C.A. Title 15, Section 78a, *et seq.* Section 10 of said Act, Title 15, U.S.C.A. Section 78j, provides:

“It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . (b) to use or employ, in connection with the purchase or sale of any security registered on a

national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”

This action arose further under Rule X-10B-5, promulgated by the Securities and Exchange Commission under said Section. Rule X-10B-5, 17 C.F.R. Section 240.10b-5, provides:

“It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange. (1) to employ any device, scheme or artifice to defraud, (2) to make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.”

Respondents’ motions to dismiss Appellant’s complaint under Rule 12(b)(1) and Rule 3 of the Rules of Civil Procedure were sustained in part as follows:

“It Is Further Ordered, Adjudged and Decreed that the several motions of all the defendants to dismiss the action under Rule 12(b)(1) of the Rules of Civil Procedure for lack of jurisdiction over the

subject matter, it appearing on the face of the complaint that there is no diversity of citizenship between the parties and that the action does not involve a controversy under the Constitution and laws of the United States, be and the same is hereby granted upon the sole ground that the transactions complained of do not involve a security traded in or upon a securities exchange or upon an 'over-the-counter' market and are therefore not within the purview of the Securities Exchange Act of 1934 which is set forth in the complaint as the basis of jurisdiction, and plaintiff's complaint and the cause or causes of action alleged therein are hereby dismissed with costs, and

"It Is Further Ordered, Adjudged and Decreed that the several motions of all the defendants to dismiss under Rule 12(b)(1) of the Rules of Civil Procedure on the ground that the Securities Exchange Act of 1934 does not provide a civil right of action for the type of action alleged in plaintiff's complaint is denied, and

"It Is Further Ordered, Adjudged and Decreed that the several motions of all the defendants to dismiss under Rule 3 of the Rules of Civil Procedure on the ground that said action has not been commenced within the time limited by law is hereby denied." (R. 40, 41).

Jurisdiction of the United States District Court was based upon Title 28, U.S.C.A., Section 1331 and Title 15, U.S.C.A., Section 78aa, and it is alleged that the amount in controversy exceeds \$3,000.00, exclusive of interest and costs (R. 4, 5).

Jurisdiction of this appeal is conferred upon the United States Court of Appeals for the Ninth Circuit by reason of Title 28, U.S.C.A., Section 1291.

STATEMENT OF THE CASE

This case was dismissed upon motions directed to the complaint under Rule 12(b)(1) and Rule 3 of the Rules of Civil Procedure (R. 25-35, 38-41). This being an action for fraud and deceit, the facts are alleged in the complaint with particularity. The substance thereof is as follows:

Prior to September, 1945, plaintiff owned 781.25 shares of common stock in defendant corporation out of an authorized and issued capital stock of 7,500 shares. Plaintiff was an elderly housewife, inexperienced in business affairs, although the community of she and her deceased husband had acquired their stock originally about the year 1901 and her deceased husband had been active in the company until his death (R. 7).

The individual defendants, other than defendants McGhie and Difford, owned 5,000 shares of such stock, and were the directors and officers of the defendant corporation, and are hereinafter referred to as the "Control Group" (R. 7-8). It is alleged that for many years the Control Group have been in actual management

subject matter, it appearing on the face of the complaint that there is no diversity of citizenship between the parties and that the action does not involve a controversy under the Constitution and laws of the United States, be and the same is hereby granted upon the sole ground that the transactions complained of do not involve a security traded in or upon a securities exchange or upon an 'over-the-counter' market and are therefore not within the purview of the Securities Exchange Act of 1934 which is set forth in the complaint as the basis of jurisdiction, and plaintiff's complaint and the cause or causes of action alleged therein are hereby dismissed with costs, and

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The individual defendants, other than defendants McGhie and Difford, owned 5,000 shares of such stock, and were the directors and officers of the defendant corporation, and are hereinafter referred to as the "Control Group" (R. 7-8). It is alleged that for many years the Control Group have been in actual management

and control of the affairs of the corporation, and that they occupy a fiduciary relationship to plaintiff (R. 8-9).

At some time prior to September, 1945, the members of the Control Group and defendant, Samuel P. McGhie, conceived and initiated a fraudulent scheme and conspiracy to defraud plaintiff and other minority stockholders of their stock, and that defendant, W. E. Difford, joined this conspiracy at a subsequent time and took an active part (R. 9, 10).

On or about January 15, 1945, defendant, John R. Robinson, acting for and on behalf of all the defendant conspirators, falsely and fraudulently misrepresented to plaintiff the financial condition of the company; its log supply; concealed its actual timber policy; represented that the company intended to liquidate or move to Oregon; deliberately avoided providing plaintiff with full financial information on the company; concealed the plans of the Control Group and Difford to organize a sales company with interlocking directorate to exploit anticipated demand; and further concealed the fact that earnings were good and dividends warranted. Said dividends were paid shortly after her stock was fraudulently acquired by the Control Group (R. 11, 12, 13, 14).

The Control Group knew plaintiff would not sell her stock for the \$64.00 per share which she received

for it if she had known the truth about such misrepresentations and concealments. The Control Group entered into a conspiracy with defendant, Samuel P. McGhie, who, acting as undisclosed agent for the Control Group, made the following false and fraudulent misrepresentations to plaintiff deliberately, wilfully and knowingly with intent to deceive and defraud her:

“(a) That he, McGhie, held a minor position in the Robinson Manufacturing Company, and that he desired to purchase the stock of the plaintiff because its acquisition would improve his chances for advancement in the company. McGhie fraudulently concealed the fact that he was purchasing the stock of plaintiff as agent for John R. Robinson and the other defendants of the Control Group.

“(b) That McGhie offered Fifty Thousand (\$50,000.00) Dollars for the plaintiff's stock, suggesting that the sale be made via an option, calling for One Thousand (\$1,000.00) Dollars 'down' money, the balance of Forty-Nine Thousand (\$49,000.00) Dollars to be paid upon exercise of the option. McGhie suggested that the plaintiff endorse her stock and place the same in escrow with his bank, pending that bank's receipt of McGhie's Forty-Nine Thousand (\$49,000.00) Dollars. McGhie fraudulently concealed that the offer was made pursuant to the fraudulent plan as aforementioned and that the option would be exercised by John R. Robinson and/or the Control Group.

“(c) That he, McGhie, had One Thousand (\$1,000.00) Dollars of his own money; that he would pay plaintiff a total of Fifty Thousand

(\$50,000.00) Dollars for plaintiff's 781.25 shares of stock; that he would raise the balance of Forty-Nine Thousand (\$49,000.00) Dollars. That, in fact, McGhei's mother never contemplated advancement of the money for the purchase of the stock; that it was never intended that McGhei would own any of the plaintiff's stock, but instead he was merely purchasing it for John R. Robinson and the Control Group." (R. 14, 15, 16).

Paragraphs V, XV and XVIII(d) of the complaint set forth the allegations of use of the means and instrumentalities of interstate commerce and of the mails. Paragraph XV is as follows:

"That thereafter and pursuant to the said fraudulent plan and conspiracy, defendant, John R. Robinson, on his own behalf and as agent for the Control Group, by the use of the United States Mails, authorized and directed the First National Bank of Everett, Washington, to write to the National Bank of Commerce, in Seattle, Washington, instructing the latter bank to deduct Forty-Nine Thousand (\$49,000.00) Dollars from the account of the former bank, and to transmit and/or credit the same to the plaintiff's account, and further instructed said bank to forward the plaintiff's stock, then held by it in escrow pursuant to said option, to the First National Bank of Everett for delivery by it to John R. Robinson." (R. 17-18).

Plaintiff is informed and believes that her stock was divided between the members of the Control Group. She would not have sold her stock for less than its true

value except for such misrepresentations and concealments (R. 18).

It is further averred that plaintiff's stock was worth \$500.00 per share at the time she sold it to said conspirators, and at the time she was first able to discover the fraud by reasonable diligence in January of 1949, it was worth \$1,000.00 per share. That plaintiff has been damaged in the sum of \$340,625.00, that being the difference between the amount paid plaintiff and the market value at the time of the sale. (R. 6, 23, 40).

ASSIGNMENTS OF ERROR

1. The Trial Court erred in granting dismissal of plaintiff's complaint and in entering judgment dismissing the cause of action upon the ground that the transactions complained of did not involve a security traded in or upon an "over-the-counter" market and are therefore not within the purview of the Securities Exchange Act of 1934, which is the only basis for jurisdiction alleged in the complaint.

2. The Trial Court erred in holding that private sales of corporate stock are not within the purview of and subject to Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. Section 78j(b) and Rule X-10B-5 of the Securities Exchange Commission, 17 C.F.R. Section 240.10b-5

ARGUMENT

I. Section 10(b) of the Securities Exchange Act of 1934, and Rule X-10B-5 thereunder, apply to fraudulent conduct in all security transactions involving the use of the mails or instrumentalities of interstate commerce. Their application is not limited to securities traded upon an exchange or traded by brokers or dealers.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. Section 78j(b) provides:

“It shall be unlawful for *any person*, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange *or any security not so registered*, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.” (Emphasis supplied).

Rule X-10B-5 promulgated by the Commission thereunder, 17 C.F.R. Section 240.10b-5, provides:

“It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumen-

tality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

- (1) to employ any device, scheme, or artifice to defraud,
- (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of *any security*.” (Emphasis supplied.)

The basic issue in this case is whether Section 10(b) and Rule X-10B-5 apply to fraudulent conduct in “private” or “doorstep” transactions in securities, or whether their application is limited to fraudulent conduct in security transactions traded on an exchange or by a broker or dealer.

Defendants assert that the quoted fraud sections apply only to transactions in a security, if that security is traded on a national securities exchange, or is traded by a licensed broker or dealer.

Plaintiff’s contention is that Section 10(b) and Rule X-10B-5 apply to fraudulent conduct in all security

transactions involving the use of the mails or instrumentalities of interstate commerce. Further, plaintiff contends that an "over-the-counter" transaction is simply one that does not utilize the facilities of a securities exchange, and includes any sale or any purchase of a security, whether or not traded on a national securities exchange or handled by a broker or dealer.

Every adjudicated case, except only the instant one, has sustained plaintiff's contentions as to the application of the fraud provisions referred to. Likewise, wherever application of the phrase "over-the-counter market" has been claimed, the Courts either denied the relevancy or confirmed plaintiff's construction thereof.

Defendants' briefs in the trial court made extended references to irrelevant excerpts from the legislative history of the securities Acts and to out-of-context quotations from speeches or books written by various officials of the Securities and Exchange Commission. This procedure was initiated in *Robinson v. Difford*, 92 Fed. Supp. 145 (1950)—where the Defendants, with one exception, were identical to those in the instant case. Defendants' District Court brief in the present case was substantially a word for word duplication of the brief filed in *Robinson v. Difford*. The Securities and Exchange Commission's brief in that case anticipated this "argument" and the excerpts and quotations

of Defendants were analyzed and stripped of significance. The trial court, in a well considered opinion, denied all of the Defendants' Motions to Dismiss. In both the present and the Difford cases, Defendants cited the following excerpt from a speech delivered in 1944 by Edward H. Cashion, then counsel to the Securities and Exchange Commission, as establishing that Section 10(b) and Rule X-10B-5 *did not apply* to fraudulent conduct in a "private" security transaction:

"The Securities and Exchange Act of 1934 and its subsequent amendments were designed to regulate trading in securities—the purchase and sale of securities—on national securities exchanges and in over-the-counter markets, and to regulate brokers and dealers. The act and its amendments were designed to strengthen the fraud prevention and disclosure provisions of the prior act." (Cashion, address entitled "*Fraud on the Seller of Securities*," published in Proceedings of Twenty-Seventh Annual Convention of National Association of Securities Commissioners (1944).

Defendants failed to set forth the paragraph which immediately followed the quoted excerpt. The omitted portion is as follows:

"One step in that direction was the promulgation of a Rule by the Commission, now known as Rule X-15C1-2, adopted pursuant to Section 15(c) of the 1934 Act. That Rule prohibits fraud by brokers and dealers in either the sale or purchase

of securities. *Another loophole, however, was still to be closed in the protections administered by the Commission.*" (Emphasis ours.)

"The step to close that loophole was taken in May 1942 when the Commission, acting pursuant to Sections 10(b) and 23(a) of the Act, adopted Rule X-10B-5. This Rule embodies the broad anti-fraud provisions of Section 17(a) of the 1933 Act, and specifically prohibits fraud by *any person* in connection with the *purchase or sale* of securities." (*Ibid.* Emphasis that of Mr. Cashion.)

It is noted that Mr. Cashion stated that Rule X-15C1-2 prohibits fraudulent conduct by *brokers and dealers* in either the sale or purchase of securities. He then relates that the Securities and Exchange Commission, cognizant that a vast number of persons were still unprotected from fraudulent conduct in connection with a purchase or sale of securities, "... adopted Rule X-10B-5." Further, to fully inform the Court, Defendants should have quoted the following from Mr. Cashion's speech:

"... the Securities Act of 1933, was designed to bring about adequate disclosure of the nature of securities to be offered for sale to the public and to prevent fraud in their distribution or sale. *Although certain securities and certain security transactions are exempted from the registration provisions of that Act, there are no EXEMPTIONS FROM its anti-fraud section, Section 17(a).*" (*Ibid.* Emphasis ours.)

In this regard the Court's attention is directed to Section 17(a)—the general anti-fraud provision of the Securities Act of 1933, Title 15, U.S.C.A., Section 77q. Section 17(a), however, covers only fraud in the sale of a security, whereas, Section 10(b) of the 1934 Act is broader for it applies to fraud in the purchase as well as in the sale of a security. In *Rosenberg v. Globe Aircraft Corp.*, 80 Fed. Supp. 123 (Ed. Pa. 1948), the Court, speaking of the '33 and '34 Acts, stated that "the two Acts are unquestionably in *pari materia* and must be construed to make a consistent whole," and the Court should look "at them as one statute." The anti-fraud provisions of Section 17(a) have been held applicable to "private" sales of securities not traded on an exchange nor handled by a securities broker or dealer. *S. E. C. v. C. M. Joiner Leasing Corp.*, 320 U. S. 344 (1943); *U. S. v. Earnhardt*, 153 F.(2d) 472 (C. A. 7, 1946), *cert. denied*, 328 U. S. 858 (1946); *U. S. v. Carruthers*, 152 F.(2d) 512 (C. A. 7, 1945), *cert. denied*, 327 U. S. 787 (1946); *Bowen v. U. S.*, 153 F.(2d) 747 (C. A. 8, 1946), *cert. denied*, 328 U. S. 835 (1946); *U. S. v. Monjar*, 147 F.(2d) 916 (C. A. 3, 1943), *cert. denied*, 325 U. S. 859 (1945).

The authorities confirm plaintiff's definition of "over-the-counter markets." All decided cases reject Defendants' contention as to Section 10(b) and Rule

X-10B-5, as well as their definition of an “over-the-counter market.”

In *Speed, et al. v. Trans-America Corp.*, 99 Fed. Supp. 808 (D. C. Delaware, 1951) wherein the Defendants raised the identical propositions here advanced, the court said at page 830:

“Defendant misreads the scope of the Act when it contends that the stock purchases do not fall within the purview of the statute, and that Rule X-10B-5 cannot validly be applied to those purchases, because the Act does not attempt to regulate securities transactions not effected on an organized exchange or in the ‘over-the-counter market’. Section 10(b) makes it unlawful for ‘any person’ by the use of any means or instrumentality of interstate commerce or of the mails, to employ a fraudulent device in contravention of Rule X-10B-5 in the purchase of ‘any security registered on a national securities exchange or any security not so registered’ . . . An ‘over-the-counter’ transaction is simply one which does not utilize the facilities of a securities exchange, but under the unambiguous provisions of the Act, it covers the sale or purchase of a security on a doorstep, as well as the trading of a professional securities broker. It would appear that over-the-counter transactions, as such, are not specifically regulated by the Act, but they are dealt with through provisions directed at the trading activity of ‘any person’ in ‘any security’. In short, *Congress did not intend to limit application of the Act to transactions on exchanges and in the organized over-the-counter markets maintained by brokers and dealers.*” (Footnote: See

H. R. Rep. No. 2307, 75 Cong., 3d Sess. (1938) p. 2: "*Under the Securities Exchange Act of 1934, the over-the-counter markets are deemed to include all transactions in securities which take place otherwise than upon a National Securities Exchange. These markets are immense, the activities embraced therein are varied, and they are of the utmost importance to the national economy.*") (Emphasis ours.)

Wallace R. Fulton, Executive Director of the National Association of Securities Dealers, Inc., in *Fundamentals of Investment Banking*, Sec. 8, p. 42 (Investment Bankers Association of America, 1947) said:

"First of all, what is meant by the over-the-counter market? *Briefly, this market embraces all transactions in securities not made on stock exchanges.*"

See also the definition of "over-the-counter market" in Munn, *Encyclopedia of Banking and Finance*, (1937) p. 545, as "The market for securities not listed on any regularly organized exchange."

As previously mentioned, the Defendants and the material facts in the instant case are practically identical to those in *Robinson v. Difford*, 92 Fed Supp. 145. The securities transaction involved in each case was a "private" one, as the stock was never traded on a national exchange or handled by a broker or dealer. In the Difford case the Defendants interposed the same

Motion to Dismiss on the ground that Section 10(b) and Rule X-10B-5 only covered fraudulent conduct in securities traded on a national exchange or handled by a broker or dealer. The briefs of the Defendants in that case were substantially identical to those submitted in the instant case, and the trial court heard extensive oral argument thereon. In rejecting all of the contentions of the Defendants in the Difford case the Court stated that Section 10(b) and Rule X-10B-5 applied to fraudulent conduct in security transactions not registered on an exchange as well as those which were registered, and held it entirely irrelevant whether or not the securities involved were ever traded in what the Defendants characterize as “over-the-counter market.”

The Defendants’ version of Mr. Cashion’s speech, as hereinbefore discussed, together with other irrelevant excerpts from legislative history were considered—and rejected—by the trial court for the obvious reason that Section 10(b) and Rule X-10B-5 are so clear and unambiguous that it is not necessary to consider the preamble or “legislative history.” The pertinent parts of the opinion are as follows:

“Plaintiffs have expressly and solely grounded their action on Section 10(b) of the Securities Exchange Act of 1934 and rule X-10B-5 promulgated thereunder by the Securities Exchange Commission.

“The defendants have filed a motion to dismiss the complaint under rule 12(b) of the Federal Rules of Civil Procedure, 28 U.S.C.A. Their contentions can be summarized as follows:

1. The court lacks jurisdiction of the subject matter because, contrary to the requirements of the Securities Exchange Act, the transactions complained of did not involve securities traded on a securities exchange or in the over-the-counter market.

2. The court lacks jurisdiction of the subject matter because the Securities Exchange Act does not provide a civil right of action for the type of transaction described in the complaint. (p. 147).

* * * * *

“Defendants’ first argument for the dismissal of the complaint is that the Securities Exchange Act does not apply where, as in the present case, the securities in question were neither registered on a national exchange nor traded in the over-the-counter market. *Clearly this argument is without foundation.*” (p. 147, Emphasis ours).

* * * * *

“The Act applies both to securities registered on a national securities exchange and to ‘any security not so registered’. Rule X-10B-5 clearly makes the acts set forth in the complaint unlawful. Consequently, the Act applies to the present case even though the securities involved were not registered on a securities exchange and were never traded in the over-the-counter market. This is so

clear from the language of section 10(b) itself that no other proper interpretation is possible. However, defendants vigorously contend that the limited purpose of the Act was to regulate only transactions in securities registered on a national exchange or traded in the over-the-counter market, and not to regulate private transactions. In support of this contention they point to the preamble statement (section 2, 15 U.S.C.A. and 78b) of the general purpose of the Act and to statements made by members of Congress when the Act was under consideration therein. Without deciding that these statements do show such a limited purpose as is contended by defendants, this court must reject defendants' contention, because section 10(b) itself, under which the present action was brought, is unambiguous. Reliance on the preamble statement of section 2 in order to alter the plain and unambiguous provisions of section 10(b) would violate a basic canon of statutory construction that statements in a preamble may be referred to only for the purpose of clarifying an ambiguity in a statutory provision. Likewise, the legislative history of an act may not properly be considered in construing an unambiguous statutory provision such as section 10(b). There are no other sections of the Act which indicate that Congress intended to limit the application of the Act to transactions involving either registered securities or unregistered securities traded in the over-the-counter market. (p. 148).

“(6) Defendants also contend that the Act does not create a civil right of action in people who may have been injured by a violation thereof. This argument, however, has been rejected by a number of decisions, including decisions of this court:

Kardon v. National Gypsum Co., D.C.E.D. Pa. 1946, 69 F. Supp. 512; *Fry v. Schumaker*, D.C.E.D. Pa. 1947, 83 F. Supp. 476; *Rosenberg v. Globe Aircraft Corp.*, D.C.E.D. Pa. 1948, 80 F. Supp. 123; *Hall v. American Cane & Pretzel Co.*, D.C.E.D. Pa. 1947, 71 F. Supp. 266." (p. 149).

The factual situation in *Kardon v. National Gypsum*, 69 Fed. Supp. 512, is substantially identical to that of the instant case. There were but four shareholders in the Defendant company, the stock had never been traded on a national exchange, nor had it ever been handled by a securities broker or dealer in what the Defendants characterize as an "over-the-counter" transaction. The brief of the Defendant Slavins in the *Kardon* case argued the present Defendants' definition of "over-the-counter market":

"Only four persons, the two plaintiffs and the two defendants are involved in the purchase and sale of the securities in question, i.e. the common stock of the two Michigan corporations, *which was never listed on any Exchange, nor traded in the Over-the-Counter market.* Between them, the four owned all of the outstanding capital stock of the two corporations. There is no outside interest in any of the securities of the two Michigan corporations; there is, therefore, no public interest involved. There is no room for any public interest, since the two Kardons and the two Slavins hold all of the outstanding stock to the exclusion of the public. Nor are there any investors whose interest requires protection. *The plaintiffs cannot claim to*

belong to the investing public insofar as these two corporations are concerned." (Emphasis ours.)

The trial court, in denying the Motion to Dismiss, said at page 514:

" . . . the whole statute discloses a broad purpose to regulate securities transactions of all kinds, and as part of such regulation the specific section in question provides for the elimination of all manipulation or deceptive methods in such transactions . . . I cannot agree . . . that investors (as used in Section 10(b)) is limited to persons who are about to invest in a security or that two men who have acquired ownership of the stock of a corporation are not investors merely because they own one-half of the total issue."

In a second Kardon opinion, 73 Fed. Supp. 798, the court again renounced the contention of the Defendants:

"The acts of the defendants specified in the complaint constituted a violation of the Act. *Section 10(b)* makes it unlawful to use any deceptive device, in contravention of the Commission's rules, in connection with the purchase of *any security registered or unregistered*. *Rule X-10B-5* specifically makes it unlawful to 'employ any device * * * to defraud * * * to omit to state a material fact necessary to make the statements made * * * not misleading or to engage in any act, practice or course of business which * * * would operate as a fraud or deceit * * *.' Under any reasonably liberal construction these provisions apply to direc-

tors and officers who, in purchasing the stock of the corporation from others, fail to disclose a fact coming to their knowledge by reason of their position, which would materially affect the judgment of the other party to the transaction.” (page 800, Emphasis supplied).

In *Grand Lodge of International Association of Machinists v. Highfield, et al.*, D.D.C. Civ. No. 3661-48, Jan. 24, 1949 (no opinion), the defendant officers and directors were charged with fraud in a purchase of stock that was not registered on a national exchange or traded by a broker or dealer. The Defendants’ Motion to Dismiss stated, *inter alia*:

“ . . . the defendants are not, and were not brokers, dealers in securities . . . furthermore, it is not alleged that the stock purchased by these defendants was listed on an exchange or traded in over-the-counter. The fact is, it was not so listed, and so far as these defendants are aware, was not traded in an ‘over-the-counter market’ . . . ”

Slavin, et al. v. Germantown Fire Insurance Co., 174 F.(2d) 799 (C.A. 3, 1949), likewise supports the contention of the plaintiff that Rule X-10B-5 applies to fraudulent conduct in “private” security transactions. The stock in question was not traded on an exchange nor effected through a securities broker or dealer. Violation of Rule X-10B-5 was charged. The Court of Appeals directed a dismissal of the action only because

it felt that Rosenlund's conduct at the "last minute" was such that it removed the aroma of fraud from his activities. It is abundantly clear that the Circuit Court of Appeals would have held that Rule X-10B-5 applied to this "private" transaction if Rosenlund's otherwise fraudulent activities had not been cleansed by his last minute disclosures.

The cited decisions clearly establish that the application of Section 10(b) and Rule X-10B-5 is not limited to security transactions on a national exchange or which are traded by a broker or dealer. Further, the phrase "over-the-counter market" is a blanket term covering all security transactions not conducted through the medium of a national exchange.

Every contention concerning applicability of the Securities Exchange Act of 1934 urged by defendants in the instant case was raised, exhaustively considered, and decided adversely to defendants' contentions in *Speed, et al. v. Trans-America Corporation*, 99 Fed. Supp. 808 (D. C. Delaware, 1951). The facts of the case are lengthy and complex, and will not be reviewed in detail here. A violation of Rule X-10B-5 was alleged in the purchase of securities from minority stockholders. No brokers or dealers were used to complete the transaction, and the securities were not listed or traded on any national exchange. The Defendants denied the

applicability of Rule X-10B-5 on the grounds that the securities were not listed on a national exchange nor purchased through a broker-dealer. The Defendants, as in the instant case, cited Section 2 of the preamble to the Securities Exchange Act of 1934, with the contention that the transactions were not subject to Section 10(b) and Rule X-10B-5, since they had not been accomplished through a dealer or broker, and hence, were not in the "over-the-counter market," as contemplated by the aforementioned preamble.

In rejecting each and every argument advanced by the Defendants in the instant case the court stated at pages 828 to 831:

"In my view, the facts show a violation by defendant of Rule X-10B-5, promulgated by the S.E.C. under Section 10(b) of the Securities Exchange Act of 1934. The rule is clear. It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers. The duty of disclosure stems from the necessity of preventing a corporate insider from utilizing his position to take unfair advantage of the uninformed minority stockholders. It is an attempt to provide some degree of equalization of bargaining position in order that the minority may exercise an informed judgment in any such transaction. Some courts have

called this a fiduciary duty while others state it is a duty imposed by the 'special circumstances'. One of the primary purposes of the Securities Exchange Act of 1934 was to outlaw the use of inside information by corporate officers and principal stockholders for their own financial advantage to the detriment of uninformed public security holders. I gave approval to this view of the Act in an earlier opinion in the case at bar when I denied Transamerica's motion for summary judgment.

"Moreover, I reject Transamerica's four contentions with respect to counts 2, 3 and 4 in that 1. it had no duty to disclose under Rule X-10B-5 its inside information; 2. that if the Rule requires such disclosure, it violates the Fifth Amendment to the Constitution of the United States; 3. that the Rule was not authorized by 10(b) of the Act if construed to apply to securities transactions such as those here involved because they were not effected on a stock exchange or through the media of professional broker-dealers, or to a stock purchase not involving any express misrepresentations; and 4. both Section 10(b) and Rule X-10B-5 violate the Fifth Amendment and are invalid as unconstitutional delegations of legislative powers.

"Defendant's contention that only express misrepresentations or half-truths are unlawful fails to look at the fact that an implied misrepresentation is just as fraudulent as an express one and constitutes an untrue statement of a material fact within the meaning of the governing Rule. *Charles Hughes & Co., Inc. v. S.E.C.*, 2 Cir., 139 F.(2d) 434, cert. den., 321 U. S. 786; *Kardon v. National Gypsum Co.*, 73 F. Supp. 798 at 800; *Hughes v. S.E.C.*, D.C., 174 F.(2d) 969. Defendant's liability

for nondisclosure is not based primarily upon the provision of subparagraph 2 — subparagraph 1 of the Rule makes it unlawful 'To employ any device, scheme or artifice to defraud' and subparagraph 3 outlaws 'any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person * * *'. The three subparagraphs of this broadly remedial rule are mutually supporting and not mutually exclusive as defendant contends. Defendant's breach of its duty of disclosure accordingly can be viewed as a violation of all three subparagraphs of the Rule, i. e., (1) a device, scheme, or artifice to defraud; (2) an implied misrepresentation or misleading omission; and (3) an act, practice or course of business which operates or would operate as a fraud upon the Plaintiffs.

* * * * *

"Defendant misreads the scope of the Act when it contends that the stock purchases do not fall within the purview of the statute and that Rule X-10B-5 cannot validly be applied to those purchases, because the Act does not attempt to regulate securities transactions not effected on an organized exchange or in the 'over-the-counter'. Section 10(b) makes it unlawful for 'any person' by use of any means or instrumentality of interstate commerce or of the mails to employ a fraudulent device in contravention of Rule X-10B-5 in the purchase of 'any security not so registered.' The terms 'person,' 'broker,' and 'dealer', are separately defined by subparagraph (9), (4) and (5) of Section 3(a), respectively, 15 U.S.C.A. Section 78C(a) (9), (4), (5). *These are unambiguous provisions. An over-the-counter transaction is simply one which does not utilize the facilities of a securities exchange, but under the unambiguous provisions of*

the Act it covers the sale or purchase of a security on a doorstep as well as the trading of a professional securities broker. It would appear that over-the-counter transactions, as such, are not specifically regulated by the Act, but they are dealt with through provisions directed at the trading activity of 'any person' in 'any security.' In short, Congress did not intend to limit application of the Act to transactions on exchanges and in the organized over-the-counter markets maintained by brokers and dealers. It is also shown by the broad definition of the term 'security' in Section 3(a) (10) of the Act, as construed by the courts. *S.E.C. v. W J. Howey Co.*, 328 U. S. 293; *S.E.C. v. C. M. Joiner Leasing Corp.*, 320 U. S. 344; *Kardon v. National Gypsum Co.*, E. D. Pa., 69 F. Supp. 512; *Slavin v. Germantown Fire Insurance Co.*, E. D. Pa., 74 F. Supp. 876, *affd.*, 3 Cir., 174 F.(2d) 799; *Speed v. Transamerica*, D. C. Del., 71 F. Supp. 457. Judge Grim has been the first to consider specifically the question whether Section 10(b) and Rule X-10B-5 apply to transactions in securities not traded on an exchange or in the over-the-counter market. He concluded that the applicability of the rule 'is so clear from the language of Section 10(b) itself that no other interpretation is possible.' See *Robinson, et al., v. Difford, et. al.*, E. D. Pa., 92 F. Supp. 145.

"Under the 'deceptive device or contrivance' clause of Section 10(b) of the Securities Exchange Act of 1934, the S.E.C. is authorized to adopt the anti-fraud provisions of Rule X-10B-5 which are applicable to a stock purchase such as made by Transamerica in the case at bar. All through its lengthy argument on this point, defendant improperly assumes that the word 'deceptive' must be

limited to market manipulations. Market manipulation is but one specific type of deceit. To limit the term 'deceptive' to that type of deceit would run counter to the principle language of Section 10(b). In none of the cases cited, immediately above, was there any element of market manipulation. The acts were based solely on a fraudulent sale or purchase of securities."

II. A Private Civil Action May Be Maintained for Violation of Rule X-10B-5.

The trial court decided this point in favor of appellant.

This subject was so fully presented in the trial brief of the *Amicus Curiae*, the Securities and Exchange Commission, that we feel unable to improve thereon and therefore adopt same as follows:

Defendants' motions to dismiss are also based on the contention "that the Securities Exchange Act of 1934 does not provide a civil right of action for the type of transactions alleged in the complaint" (R. 26, 32). This defense was also rejected in the *Robinson v. Difford* case. Defendants' argument is that since no private action is expressly provided by the 1934 Act for a violation of a rule under Section 10(b), a violation of Rule X-10B-5 can only give rise to action by the government, and cannot afford a private person, who has

been injured by the violation, the right to maintain an action for damages or other relief. The right to maintain a private action for violation of Rule X-10B-5 has been unanimously upheld by many courts. In the *Robinson v. Difford* case, the defendants conceded that the cases were all against them, including cases decided in the same district. They contended, however, that there were no federal appellate court decisions on the question, and stated that they were raising the question to preserve their rights on appeal. They offered no further argument in the matter.

Slavin v. Germantown Fire Ins. Co., 174 F.(2d) 799 (1949), had been decided by the Court of Appeals for the Third Circuit at the time of the *Robinson v. Difford* case. The defendants in the *Slavin* case did not dispute the right of private action. They denied, however, that the Rule had been violated. A majority of the court, agreeing that no fraud had been proved, took occasion to state that "Logic and such authority as is available, seem to favor such (private) action" (174 F.(2d), at 805). The instant defendants argued, however, that this statement was merely dictum. There was also the earlier case of *Baird v. Franklin*, 141 F.(2d) 238 (1944), *cert. denied*, 323 U.S. 737 (1944), in which the Court of Appeals for the Second Circuit agreed that a private action could be maintained for violation of Section 6(b) of the 1934 Act, for which there is similarly

no express provision authorizing a private action. Plaintiffs lost the *Baird* case only because they had failed to sustain the burden of proving their damages. Subsequent to the *Robinson v. Difford* decision, the Court of Appeals for the Second Circuit expressly upheld the right to maintain a private action for violation of Rule X-10B-5. *Fischman v. Raytheon Mfg. Co., et. al.*, C.C.H. Fed. Sec. L. Rep., Sec. 90,505 (decided April 23, 1951).

In addition to the foregoing appellate cases and the *Robinson v. Difford* case, we set forth below the many cases to date in which the right to maintain a private action for violation of Rule X-10B-5 has been upheld or recognized:

Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D.Pa., 1946) (leading case discussing rationale of private action for violation of Rule X-10B-5);

Speed v. Transamerica Corp., 71 F. Supp. 457 (D. Del., 1947);

Osborne v. Mallory, 86 F. Supp. 869 (S.D. N.Y., 1949);

Hawkins v. Merrill Lynch, Pierce, Fenner & Beane, 85 F. Supp. 104 (W.D. Ark., 1949);

Fry v. Schumaker, 83 F. Supp. 477 (E.D. Pa., 1947);

Seward v. Hammond, 8 F.R.D. 457 (D. Mass., 1948);

Stella v. Kaiser, 82 F. Supp. 301 (S.D. N.Y., 1948);

Birnbaum v. Newport Steel Corp., C.C.H. Fed. Sec. L. Rep. Sec. 90,506 (S.D. N.Y., 1951);

Rosenberg v. Globe Aircraft Corp., 80 F. Supp. 123 (E.D. Pa., 1948);

Acker v. Schulte, 74 F. Supp. 683 (S.D. N.Y., 1947);

Montague v. Electronic Corp. of America, 76 F. Supp. 933 (S.D. N.Y., 1948);

Hall v. American Cone & Pretzel Co., 71 F. Supp. 266 (E.D. Pa., 1947);

Fifth-Third Union Trust Co. v. Block, S.D. Ohio, Civ. Action 1507, Dec. 11, 1946 (opinion in form of short letter to counsel stating that *Kardon* ruling is being followed);

McManus v. Jessup & Moore Paper Co., E.D. Pa., Civ. Action No. 8015, July 30, 1948 (no opinion);

Grand Lodge of International Association of Machinists v. Highfield, D.D.C., Civ. No. 3661-48, Jan. 24, 1949 (no opinion).

Because of these many decisions we do not propose to argue the question at length. For the information of the Court, however, we observe that

the implied right of private action under Rule X-10B-5 has been predicated primarily upon the basic tort doctrine that a person whose interest has been invaded as the result of another's violation of a statute intended in whole or in part for the protection of that interest is entitled to obtain private relief for such invasion. See *Restatement of Torts*, Sec. 286. There is, in addition, Section 29(b) of the 1934 Act, 15 U.S.C.A. Sec. 77cc(b), which provides that any contract made in violation of the Act shall be void as respects the rights of the violator. (An amendment to Section 29(b) in 1938, 52 Stat. 1076, providing *inter alia*, a short statute of limitations with respect to actions for violation of Commission rules under Section 15(c)(1) of the 1934 Act, 15 U.S.C.A. Sec. 780(c)(1), which, like Section 10(b) does not specifically provide for a private action, gives additional support for the right to maintain such action; for, by implication, the amendment suggests that Congress always assumed the availability of private actions under Section 15(c)(1) and similar provisions such as Section 10(b).) Whereas Section 29(b) only authorizes recovery based on the voiding of the contract, the first mentioned doctrine provides in addition the basis for recovery of tort damages. For a comprehensive discussion of the question, see the *Kardon* opinion, *supra*, and a student article, *The Prospects for Rule X-10B-5: An Emerging Remedy for Defrauded Investors*, 59 Yale L. J. 1120, 1133 *et seq.* (1950).

Not only has no court ever denied the right of private action for violation of Rule X-10B-5, but, on the contrary, the underlying rationale has been applied to permit private lawsuits for violations of other provisions of the federal securities laws which similarly contain no express authorization for such actions. See, e.g., *Remar v. Clayton Securities Corp. et al.*, 81 F. Supp. 1014 (D. Mass. 1949); *Appel v. Levine*, 85 F. Supp. 240 (S.D. N.Y., 1948), and *O'Connell et al. v. Mallory et al.*, C.C.H. Fed. Sec. L. Rep. Sec. 90,445 (S.D. N.Y., 1949) (Regulations T and U under Section 7 of Securities Exchange Act of 1934); *Osborne et al. v. Mallory et al.*, 86 F. Supp. 869 (S.D. N.Y., 1949) (Section 17(a) of the 1933 Act; Section 15(c)(1) of the 1934 Act and Rule X-15C1-2 thereunder); *Hawkins v. Merrill Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W.D. Ark., 1949) (Sections 11(d) and 17 (a) of the 1934 Act, and Rule X-17A-5 thereunder); *Fischman v. Raytheon Mfg. Co. et al.*, C.C.H. Fed. Sec. L. Rep. Sec. 90,505 (C.A. 2, 1951) (Section 17(a) of the 1933 Act, *dictum*). *Speed v. Transamerica Corp.*, 99 Fed. Supp. 808 (D.C. Delaware, 1951).

III. Defendants' Use of Instrumentalities of Interstate Commerce and of the Mails to Effect Payment for, and to Obtain Delivery of, Plaintiff's Securities are Sufficient Under Rule X-10B-5.

The trial court decided this point in favor of appellant.

On this subject also we adopt the brief of *Amicus Curiae* in the Trial Court as follows:

The motion to dismiss filed by defendants other than Difford is based also on plaintiff's asserted failure to allege any uses of the mails, instrumentalities of interstate commerce, or facilities of any national securities exchange in connection with the fraud practiced upon plaintiff. It appears, however, that in Paragraph V the complaint does allege, albeit in general terms, that "the mails, telephone, telegraph and other means and instruments of transportation in interstate commerce" were used in connection with the asserted fraud (R. 6). In Paragraph XV there is also a specific allegation that defendant John R. Robinson, on his own behalf and acting for the other defendants participating in the scheme at that time, used the mails to cause the First National Bank of Everett to instruct the National Bank of Commerce in Seattle, Washing-

ton, to transfer a credit of \$49,000 to plaintiff's account in the latter bank in payment for her stock, and to forward her shares, theretofore held in escrow pursuant to an option agreement, to the Everett bank for delivery to Robinson (R. 17). Subsequently, in Paragraph XVIII(d), plaintiff alleges further uses of the mails and instrumentalities of interstate commerce in connection with the later purchases from other minority stockholders (R. 21).

Whether or not Paragraph V, had it stood alone, would have been objectionable because of its generality (See in this connection, *S.E.C. v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Calif., 1938)) is an academic question in this case because Paragraphs XV and XVIII(d) do allege specific uses of the mails. The relevancy and sufficiency of the allegations of Paragraph XVIII(d) involve mixed questions of fact and law relating to the nature and scope of the scheme to defraud. The allegations of Paragraph XV, we believe, are clearly sufficient; for they specifically charge that the defendants caused the mails to be used to effect payment of the purchase price and to obtain delivery of plaintiff's shares.

Defendants' motion did not specify why they regard the last-mentioned uses of the mails as insufficient; and we shall not speculate as to the possible basis of their contention. Suffice it to observe that under Rule

X-10B-5, as well as under Section 17(a) of the 1933 Act upon which the Rule is patterned, jurisdiction exists if the defendants use the mails, or cause others to use them, at any point in the furtherance of defendants' fraud. *Slavin v. Germantown Fire Insurance Co.*, 174 F.(2d) 799 (C.A. 3, 1949); *U. S. v. Monjar*, 147 F.(2d) 916 (C.A. 3, 1943), *cert. denied*, 325 U.S. 859 (1945); *Kopald-Quinn v. U. S.*, 101 F.(2d) 628 (C.A. 5, 1939), *cert. denied*, 307 U. S. 628 (1949); *Landay v. U. S.*, 108 F.(2d) 698 (C.A. 6, 1939); *S.E.C. v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Calif. 1939). Such uses include, of course, mailings pertaining to payment for the security, or to the delivery of the security pursuant to the sale agreement. *Mansfield v. U. S.*, 155 F.(2d) 952 (C. A. 5, 1946), *cert. denied*, 329 U. S. 792 (1946); *U. S. v. Earnhardt*, 153 F.(2d) 472 (C.A. 7, 1946), *cert. denied*, 328 U. S. 858 (1946); *Bogy v. U. S.*, 96 F.(2d) 734 (C.A. 6, 1938), *cert denied*, 305 U. S. 608 (1938); *S.E.C. v. Wimer*, 75 F. Supp. 955 (W. D. Pa., 1948); *U. S. v. Vidaver*, 73 F. Supp. 382 (E.D. Va., 1947). The underlying rationale is that the basic purpose of the anti-fraud provisions of the federal securities laws is to outlaw fraudulent securities transactions wherever possible within the scope of Congressional power, and that the requirements relating to the use of the mails or facilities of interstate commerce were intended only to provide the necessary

jurisdictional props to support this Congressional program. Accordingly, the jurisdictional clauses are given broad scope. Plaintiff's allegations fall well within the foregoing rationale and decisions, and are sufficient.

IV. The Action Was Timely Commenced.

The trial court decided this point in favor of appellant.

This action was within the plain and direct language of the Washington statute, Rem. Rev. Stat. 159(4), which provides as follows:

“Within three years:

4. An action for relief upon the ground of fraud, the cause of action in such case not to be deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud;”

The Washington Supreme Court repeatedly has held that it is the “gist,” “substance” and “gravamen” of an action—not its procedural form—that is determinative of the section of the statute of limitations applicable thereto. *McDonald v. Camas Prairie R. Co.*, 180 Wash. 555, 557, 38 Pac. (2d) 515, 516; *Rundin v. Sells*, 1 Wn.(2d) 332, 95 Pac.(2d) 1023.

“To determine whether an action is one upon contract or in tort, attention will be given to the

substance of the action rather than to the form and the nature of the right the violation of which creates the right of action." *McDonald v. Camas Prairie R. Co.*, *supra*, in which decision, all of the above quoted words are used.

Actionable fraud is incapable of precise definition, but the following will indicate the extremely broad scope thereof:

"The term 'fraud' is used in various senses, and fraud assumes so many different degrees and forms that courts are compelled to content themselves with comparatively few general rules for its discovery and defeat, and allow the facts and circumstances peculiar to each case to bear heavily on the conscience and judgment of the court or jury in determining its presence or absence. In fact, the fertility of man's invention in devising new schemes of fraud is so great that courts have always declined to define it, reserving to themselves the liberty to deal with it under whatever form it may present itself. Nevertheless, while it has often thus been said that fraud cannot be precisely defined, the books contain many definitions, such as unfair dealing; an artifice by which a person is deceived to his hurt; a wilful, malevolent act, directed to perpetrating a wrong to the rights of others; anything which is calculated to deceive, whether it is a single act or a combination of circumstances, or acts or words which amount to a suppression of the truth, or mere silence; deceitful practices in depriving or endeavoring to deprive another of his known right by means of some artful device or plan contrary to the plain rules of common honesty; the unlawful appropriation

of another's property by design; and making one state of things appear to a person with whom dealings are had to be the true state of things, while acting on the knowledge of a different state of things. Fraud has also been said to consist of conduct that operates prejudicially on the rights of others and is so intended; a deceitful design to deprive another of some profit or advantage; or deception practiced to induce another to part with property or to surrender some legal right, which accomplishes the end desired. Fraud, therefore, in its general sense, comprises all acts, omissions, and concealments involving a breach of legal or equitable duty, trust, or confidence, and resulting in damage to another. . . ." 23 *Am. Jur. Page* 753, *Section 2, Fraud and Deceit*.

Only two cases have passed squarely on what state statute of limitations applies to actions under Section 10 of the Securities Exchange Act of 1934:

Osborne v. Mallory, C.C., S.D., N.Y., (1949), 86 F. Supp. 869; and

Fischman v. Raytheon Mfg. Co., C.C.H. Fed. Sec. L. Rep., Section 90, 505 (C.A. 2, 1951).

In the *Osborne* case, only the third cause of action involved Section 10(b) of the 1934 Act with which we are concerned in the present action, and in referring thereto, the Court said at page 879:

"The applicable statute of limitations to actions under Sec. 17 of the 1933 Act and Sec. 10(b) of the 1934 Act would be that of the forum, since the

two Federal Acts do not provide any period within which suits must be brought under those sections. *Seaboard Terminal Corp. v. Standard Oil Co.*, D.C., 24 F. Supp. 1018; *Dipson Theatres v. Buffalo Theatres*, D.C., 8 F.R.D. 86; *Cope v. Anderson*, 331 U.S. 461, at page 464, 67 S. Ct. 1340, 91 L.Ed. 1602. The applicable statute of limitations of the State of New York is found in the New York Civil Practice Act, Sec. 48(2) and (5), a six year statute."

The sections of the New York Act referred to by the Court are as follows:

"Sec. 48. Actions to be commenced within six years. The following actions must be commenced within six years after the cause of action has accrued:

* * *

"2. An action to recover upon a liability created by statute, except a penalty or forfeiture.

* * *

"5. Any action to procure a judgment on the ground of fraud. The cause of action in such a case is not deemed to have accrued until the discovery by the plaintiff, or the person under whom he claims, of the facts constituting the fraud." *New York Civil Practice Act, Sec. 48(2) and (5).*

In the *Fischman* case, the complaint alleged fraudulent conduct in violation of Section 10 as in the *Osborne* and instant case. Judge Frank held that Section 48(2) and (5) of the New York Civil Practice Act applied.

Thus, the only two cases directly in point support plaintiff. In New York a six-year statute applied to both liabilities created by statute and to fraud, so it was not necessary to choose between them. In Washington a two-year statute applies to the former and a three-year statute running from discovery to the latter, so a choice is necessary. If it were assumed that under the New York cases there is doubt as to whether an action under Section 10 of Securities Exchange Act of 1934 is for fraud or a liability created by statute, the applicable rule of construction is well stated in *Noble v. Martin*, 191 Wash. 39, 65; 70 Pac.(2d) 1064, 1076, as follows:

“When there is any doubt as to which of two statutes of limitation is applicable, the longer period will be applied.” (Citing cases).

Defendants contend that the case falls within the two-year limitation of Washington statute, Rem. Rev. Stat. 165, on the assertion that plaintiff seeks a recovery on a “liability created by statute.” It will be conceded that if this action is founded on a “liability created by statute” within the meaning of that phrase as determined by the Washington Supreme Court, the case would be barred by Rem. Rev. Stat. 165. However, defendants err in assuming that a liability *created by* statute is synonymous with a liability *arising out of* or *under* a statute, and in implying that the present case

is within the former term, whereas, in fact, it falls within the latter. In *Cannon v. Miller*, 22 Wn.(2d) 227, 241; 155 Pac.(2d) 500, 507 (1945), in considering limitation of actions, the Washington Supreme Court said:

“The phrase ‘liability created by statute’ means a liability which would not exist but for the statute. 37 C.J. 783, Limitations of Actions, Sec. 123; 25 Words and Phrases (Perm. ed.) 61 *et seq.*”

In the successor section to *Corpus Juris* referred to by the Washington Court, i.e., 53 C.J.S. Page 1051, Section 83(a), it is stated:

“ . . . The phrase ‘liability created by statute’ or ‘liability created by law,’ within the meaning of such a statute, has been held not to include or extend to actions arising under the common law, . . . ”

Thus, it is apparent that under the interpretation by the Washington Supreme Court of the phrase “liability created by statute” unless an action was unknown to the common law and be simply and purely a creature of legislative action, it is not deemed within the phrase insofar as the two-year catch-all section of the Washington State statute of limitations. It is not to be supposed that the learned counsel for defendants will urge that the ages old action for deceit was unknown to the common law prior to the enactment of the 1934 Act.

Incidentally, the Washington Supreme Court has placed the further limitation on the phrase "liability created by statute" in holding that an action within the meaning of the phrase cannot arise out of "agreement."

"A liability created by statute is one in which no element of agreement enters. It is an obligation which the law creates in the absence of an agreement." *Oregon-Wash. R. & Nav. Co. v. Seattle Grain Co.*, 106 Wash. 1, 8, 178 Pac. 648, 650, 185 Pac. 583.

The present case arises directly out of the contract and agreement for the sale and purchase of plaintiff's stock in defendant corporation.

No Washington decision exactly and squarely similar on its facts to the instant case has been found. The decision most nearly in point on the facts is *Union Trust Co. v. Amery*, 67 Wash. 1; 120 Pac. 539, 540. This was an action *arising out of* or *under* a Washington statute which made it unlawful for the trustees of a corporation:

"to make any division except from net profits arising from the business of the corporation, nor divide, withdraw, or in any way pay to the stockholders or any of them any part of the capital stock of the company, nor to reduce the capital stock of the company, . . ."

except as provided by statute. In this action alleging violation of this section, the Court held as follows:

“The first question presented for our consideration is whether the action is barred by the statute. A reference to the dates stated will disclose that three years had not elapsed between the purchase and sale of the stock and the adjudication of bankruptcy. We think the case falls within the provisions of Rem. and Bal. Code, Sec. 159, subd. 4, which is as follows:

‘Within three years,—

‘An action for relief upon the ground of fraud, the cause of action in such case not to be deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud’.”

It is respectfully submitted that the judgment of dismissal should be reversed.

Respectfully submitted,

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